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Global financial integration: an update

Report of the Secretary-General

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I. Introduction

1. Prompted in part by the balance-of-payments crisis in Mexico at the end of 1994 and its consequences for other countries, the General Assembly first addressed the issue of global financial integration in 1995 (see Assembly resolution 50/91 of 20 December 1995). To assist the Assembly in its further consideration of the subject in 1996, the Secretariat prepared a report covering three areas, namely the macroeconomic environment, the efficiency and stability of international financial markets, and measures to enhance access to international finance (A/51/388). In its resolution 51/166 of 16 December 1996, the Assembly set out its concerns and conclusions on the subject and called for the present report.

2. In 1997, there have been notable developments in many of the areas addressed by the General Assembly. An important further step in the process of liberalization and deregulation of global financial markets was taken in April 1997, when the Interim Committee of the International Monetary Fund (IMF) approved a plan to include the promotion of capital account liberalization among the purposes specified in the IMF Articles of Agreement.[1] The IMF Executive Board was expected to recommend key elements of such an amendment by the time of the Committee's meeting in September 1997. In the meantime, the financial turmoil that has occurred in Thailand and other South-East Asian nations has raised further questions about the adequacy of the international framework for the highly integrated global financial markets of today.

3. There is broad international agreement on the desirability of capital account liberalization, but views differ on many of the issues that have to be addressed in implementing it. At the same time, there is universal concern that individual economies, firms and individuals are vulnerable to the volatility that is currently inherent in global financial markets. In order to ensure the success of the liberalization of financial markets, complementary actions have to be taken to reduce their volatility. These actions include creating, at both the international and national levels, a sustainable macroeconomic environment, a sound financial system and appropriate prudential arrangements. There is also a need for mechanisms to address a financial crisis if preventive measures fail.

4. Reflecting the centrality of global financial integration to international economic relations and global development, these challenges have been addressed in a number of United Nations forums over the past year, notably in discussions regarding the Agenda for Development (see Assembly resolution 51/240 of 20 June 1997, annex, paras. 9, 70 and 219), discussions of the Committee for Development Planning[2] and the discussions and agreed conclusions of the high-level segment of the substantive session of 1997 of the Economic and Social Council.[3]

5. The present report, which was prepared in consultation with IMF and the World Bank, as well as with the secretariat of the United Nations Conference on Trade and Development, updates the 1996 review and builds on the intervening discussions, covering developments up to early August 1997.

II. Improving the macroeconomic environment for financial integration

A. National economic environment

6. Sound domestic macroeconomic policies are essential not only to attract international capital flows but also to avoid precipitate outflows. There is increasing agreement on the desirable nature of these policies and recognition that they are also those required to stimulate domestic investment and economic growth. The International Monetary Fund plays a key role in promulgating these policies and in translating them into action, particularly in the development of economies in transition.

7. In Madrid in October 1994, the Interim Committee of IMF adopted a declaration on a partnership for sustainable global growth,[4] which the Committee updated and broadened at its autumn (northern hemisphere) meeting in 1996.[5] This set of international guidelines for macroeconomic and financial policy was intended as a framework for policy-making by all IMF members and to guide the Fund's policy discussions with members. The guidelines therefore serve as a backdrop to the periodic confidential discussions about domestic policies that IMF undertakes with all its members under article IV of its Articles of Agreement.

8. It is noteworthy that, as the world's economies make progress, even if at different speeds, in reducing inflation, controlling the growth of money and credit, curtailing unsustainable budget deficits and liberalizing domestic financial markets, attention has begun to turn to a second generation of policy measures that are increasingly being viewed as part and parcel of the adjustment process. These include economic aspects of governance, on which the Fund's Executive Board adopted a guidance note on 4 August 1997,[6] according to which IMF policy advice and

technical assistance in this regard could encompass, in its fields of competence, institutional reform of government, reforms of market mechanisms, and regulatory and legal issues. In areas in which it did not have a comparative advantage (e.g., reform of public enterprises and the civil service, property rights and contract enforcement), the Fund would continue to rely on the expertise of other institutions, especially the World Bank. Consistent with past practice, however, policies and reforms in these areas could, as appropriate, be part of the IMF staff's policy discussions and conditionality for IMF financial support where those measures were necessary for the achievement of programme objectives.[7]

9. The Executive Board recognized that it was formally moving beyond the traditional dimensions of economic policy reform and further into the political domain of member countries. More precisely, it decided,

> "Specifically, the IMF's judgements should not be influenced by the nature of a political regime of a country, nor should it interfere in domestic or foreign politics of any member. The IMF should not act on behalf of a member country in influencing another country's political orientation or behaviour. Nevertheless, the IMF needs to take a view on whether the member is able to formulate and implement appropriate policies. This is especially clear in the case of countries implementing economic programmes supported by the IMF from the guidelines on conditionality that call on IMF management to judge that '*the programme is consistent with the IMF's provisions and policies and that it will be carried out*'. As such, it is legitimate for management to seek information about the political situation in member countries as an essential element in judging the prospects for policy implementation."[8] [Italics in original.]

10. By virtue of arriving at decisions on whether to provide financial support to macroeconomic programmes based upon, *inter alia*, judgements about the political situation, the international community is entering new terrain. By the same token, IMF has also begun to express its concern in individual country analyses about the content of government spending, as well as the more traditional concerns about the overall size of budgets and the degree of dependence on borrowing to finance them. Here again, IMF discussions will be going beyond the traditional scope of its policy dialogue with members.

B. International economic policy coordination

11. In the present globalized economy, sound domestic policies alone are insufficient to ensure sustained economic growth and avoidance of external shocks, particularly of a financial nature. There is also a need for a favourable international environment and coherence in macroeconomic policies, particularly among the world's leading economies. Inconsistencies in national policies are likely to cause disturbances in financial markets, particularly if they continue uncorrected for some time.

12. In February 1997, the finance ministers of the countries members of the Group of Seven announced that the major misalignments in exchange rates that had been noted in April 1995 had been corrected, implying that they believed that the exchange rates had reached appropriate levels. Since then, however, the major European currencies, with the exception of the British pound, have weakened further against the United States dollar, with the French franc, German mark and Italian lira falling by over 11 per cent between February and mid-August 1997. Faced with slow economic growth and high unemployment in Europe, policy makers have focused more on keeping interest rates low rather than tackling the exchange rate movements, indicating that the degree of coordination of macroeconomic policies of major economies ebbs and flows according to the economic situations within these countries.

13. This decision also reflects the fact that policy makers recognize that their ability to counter market forces is limited. Instead, many of their actions are intended to mobilize market forces to achieve their objectives. In the financial sector, as elsewhere, there is increasing reliance on the power of market forces to exercise discipline and thereby correct unsound behaviour.

III. International cooperation to strengthen financial integration

14. There is general agreement that international finance in the 1990s can be quick to respond to opportunities in the developing and transition economies. However, many countries do not share in these inflows. Also, the quality of inflows varies widely and a preponderance of short-term placements of funds can cause serious difficulties for macroeconomic policy managers. Successfully attracting long-term inflows generally requires building the confidence of the investing community in the stability and sustainability

of the political, economic and social environment of the host country. Macroeconomic policy surveillance, as discussed in section II above, is meant to contribute to this confidence, as are other recent international policy developments.

A. Development of international standards for national financial systems

15. Between 1980 and 1996, at least two thirds of all IMF member countries experienced serious problems in the financial sector.[9] Moreover, financial crises in developing countries have tended to be more severe relative to the size of the economy than comparable crises in developed countries.[10] Hence, the need for reform of the financial sector has become increasingly salient.

16. While recognizing the differences among countries, it has been increasingly considered that jointly developed guidelines or standards in this area would be useful. As a result, the Basle Committee on Banking Supervision (BCBS) has worked on this issue in close collaboration with supervisory authorities, including several outside the Group of Ten member countries (marking the first time that developing and transition economies had been involved in drafting global banking standards).[11] In April 1997, BCBS proposed a set of core principles for effective banking supervision, applicable in both Group of Ten member countries and non-member countries.[12] Following agreement on a final text, supervisory authorities throughout the world would be encouraged to give their formal endorsement of the core principles as a basic reference for all supervisory and other concerned public authorities. The implementation of the principles would be monitored by BCBS, together with other interested organizations. In particular, IMF and the World Bank would meet semi-annually with BCBS to evaluate the implementation of the principles.

17. The development of international standards for domestic financial policies has also been pursued outside the banking context. In response to an initiative of the Group of Seven at their 1996 Lyons Summit meeting, a 15-nation working party[13] was asked to prepare a strategy to foster financial stability in emerging market economies. In its report,[14] released in April 1997, the working party proposed that representatives of the Group of Ten and emerging market economies develop an international consensus on key elements of a sound financial and regulatory system. It would look to international groupings of national authorities (such as BCBS, the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors) to formulate norms, principles and practices within their areas of expertise. It would seek to build market discipline and incentives into regulatory regimes to foster better corporate governance and a more robust financial sector.

18. At the same time, the working party recognized that political and social consensus was required to adopt the measures needed for financial stability and that there could be no rigid timetable for reform. Even though reforms were in many cases urgent, the time required for their implementation would differ considerably, depending on the nature of the reform and the need for appropriate sequencing.

19. The working party considered that delineating a concerted international strategy to promote the establishment, adoption and implementation of a consistent set of sound principles and practices would be a major landmark. In order to develop a broad consensus, however, it considered that it would be useful to embark on consultations with a larger group of countries, and it proposed that, in addition to informal contacts, further meetings should be convened to consider the proposed approach. Market participants would also be involved in consultations.

20. It will be for individual countries to decide on the extent to which they adopt the international standards as domestic policy, but the multilateral institutions would be called upon to foster adoption and assist in implementation of the agreed principles. Building on current practices, strengths and experience, the European Union, IMF, the World Bank and the regional development banks would provide technical assistance in their areas of expertise to developing countries and economies in transition. The development banks could also help finance reform of the financial sector and structural measures to strengthen financial systems.

21. The multilateral institutions, however, do not see themselves as being in the business of rating banking systems or as certifying a system as sound or otherwise; this is reflected in the guidelines adopted by the IMF Executive Board on 4 August 1997, which stated, *inter alia*, that the mandate and resources of IMF did not allow the institution to adopt the role of an investigative agency or guardian of financial integrity in member countries and that there was no intention to move in that direction.[15] Rather, in the realm of banking, for example, they are breaking down the core principles into a comprehensive checklist that would assist them in providing guidance to clients.[16]

B. Towards full and timely provision of national economic and financial data

22. Agreed standards for oversight of the financial sector were deemed important, not only for the strengthening of the financial sector itself but as a confidence-building measure aimed at international investors. The international community has adopted other initiatives in this regard in recent years, including the effort to make transparent, if not harmonize, basic economic and financial data about countries, and encourage wide dissemination of the data. In this regard, IMF launched its Special Data Dissemination Standard (SDDS) in April 1996 to guide members that have or might seek to have access to international capital markets and wish to ease provision of their economic and financial data to the public. Adopting SDDS is voluntary, but a country that subscribes to the standard is expected to submit information about its data and its dissemination practices — its metadata — to IMF for publication on its electronic bulletin board, the IMF Dissemination Standards Bulletin Board (DSBB). The transition period during which a country may subscribe to SDDS, even though its dissemination practices are not yet in line with it, has been set to end in December 1998. By June 1997, 42 countries, of which 16 were developing countries and 6 economies in transition, had subscribed to SDDS. Of those countries, 14 developing countries and 5 economies in transition had posted their metadata with IMF.[17] A total of 8 subscribers, of which 6 are developing countries, had provided links from the IMF bulletin board to national summary sites, allowing electronic access to actual data. Work is also proceeding on a general data dissemination standard to guide the provision of data to the public by all IMF members.

23. Besides making data more readily available and understood, IMF has begun to disseminate more of its analysis of country situations. The Fund engages in periodic discussions about domestic policies with all of its members under article IV of its Articles of Agreement, but these are confidential. In April 1997, however, the Executive Board agreed to issue press information notices about its article IV consultations if the country also agreed. These notices are three to four pages in length and contain a background section with factual information on the member country's economy, including a table of economic indicators, and an assessment by IMF of the member country's economic prospects and policies, as reflected in the Executive Board's discussions of the article IV review of the member country's circumstances. The publication of such information should provide the international financial community with a valuable assessment of a country's economic health. As missions undertaken under article IV also look more thoroughly at financial system issues than in the past, the notices can be expected to begin to cover this sector.

C. Emergency financing

24. Widely available and reliable data and positive reviews of a country's economic situation might not always deter an adverse reaction in financial markets. Managers of financial assets perforce operate with imperfect information and a premium is put on quick responses to changing circumstances. Especially in the short term, markets do not always operate rationally and even a country in a fundamentally sound situation could be harmed by the herd instinct of financial investors and the speculative flows that they set in motion. Hence, even improvements in policy and information flows are unlikely to obviate completely the need for a cooperative effort among countries in providing international financial safety nets.

25. The availability of a large volume of funds has been viewed as one means of helping to deter an unjustified attack on a currency, while actual use of the funds could help fight an attack. After the Mexican crisis, IMF in September 1995 established the Emergency Financing Mechanism (EFM) (see A/51/388, paras. 60-62), which is a decision-making mechanism, not a separate credit facility, available to any country with an appropriate record of policy reform and management. It makes it possible for IMF to respond quickly when the member faces an external financial crisis and seeks assistance. This was the case for the Philippines in July 1997 when IMF used EFM for the first time.[18] As the Philippines already had an operative credit from the IMF Extended Fund Facility (EFF) in support of its economic programme, EFM enabled IMF to respond within a week to a request that the special drawing rights (SDR) 474.5 million (US$ 652 million) EFF be extended from 23 July 1997 to 31 December 1997 and that it be augmented by a further SDR 316.7 million (US$ 435 million).

IV. Enhancing prudential oversight of financial markets

26. Throughout the world, controls on many economic sectors and activities are increasingly being relaxed as part of the global trend towards more liberalized economies and greater reliance on unrestrained market forces rather than government intervention. The financial sector, however, continues to be viewed as deserving of special consideration

because of its central role in the national economy and the far-reaching damage that financial disruption, caused for instance by imprudent lending or unanticipated changes in prices, can produce in the domestic economy. Prudential controls on the financial sector at the national level have thus long been seen as essential to reducing those risks to the economy as a whole. In a financially integrated world, such controls are also seen as necessary for increasing international confidence in the domestic financial system and thereby attracting external capital flows.

27. At the same time, prudential banking standards might serve as barriers to entry into domestic markets for financial services and therefore be inconsistent with the efforts of the World Trade Organization (WTO) to liberalize trade in this area. There is a need to achieve consistency between prudential measures and the negotiations under WTO auspices designed to ease entry conditions and to produce a level playing field for domestic and foreign firms in the financial sector.

A. International prudential supervision

28. In the increasingly financially integrated global economy, disruptions in national financial markets can readily spread to other countries, with similarly far-reaching effects, as recent experiences have shown. National regulations therefore need to be reinforced by an international framework of controls.

29. Much of the effort to strengthen the international oversight framework is being carried out by three permanent committees of the Bank for International Settlements (BIS) that report to the central bank governors of the Group of Ten, namely, BCBS, the Euro-Currency Standing Committee (ECSC), and the Committee on Payment and Settlement Systems (CPSS). Recommendations of these bodies are non-binding; responsibility for introducing and enforcing the agreed regulations rests with the national legislative bodies.

30. There has been growing collaboration between the three above-mentioned committees and international non-governmental associations of financial institutions, including IOSCO, IAIS, and the International Accounting Standards Committee, as well as with banking regulators from countries other than the Group of Ten.

B. Financial risk management

31. A central area of concern of the various supervisory authorities has been the capacity of the financial institutions under their responsibility to manage risk adequately, especially in a global market of complex and changing financial instruments. The rapid pace of change in global financial markets and instruments has made it difficult to keep regulations up to date. The challenge remains to adapt regulatory structures to the ongoing process of financial innovation.

32. In 1988, when international finance was still almost completely a matter of international banking, BCBS adopted guidelines for minimum capital adequacy standards for banks. The risk to be covered was credit risk — the risk that a borrower would be unable to pay interest or principal in a timely manner. These standards were initially implemented by the countries members of the Group of Ten but the Basle Capital Accord has since become the international standard and has been adopted in more than 100 countries. The Accord has fostered more prudent banking by helping to reverse the erosion of capital ratios. It has, however, also contributed significantly to the levelling of the international playing field, as national authorities had previously held different requirements for the capital backing of their banks.

33. In December 1996, BCBS extended the Capital Accord to market risks — the risk of losses arising from movements in the prices of financial instruments. This amendment, which is due to come into force at the end of 1997, will allow a bank to calculate its capital charges for market risk using either a standardized method or the model it uses internally to track the bank's exposure. The value at risk (VAR) that is calculated by either method is to be multiplied by a factor of three to determine the amount of capital to be set aside for market risk.[19] The amendment (as well as the original Accord) would be applicable to all banks, both domestic and internationally active.

34. In January 1997, BCBS published a consultative paper dealing with interest rate risk, which is a bank's financial exposure to adverse movements in interest rates.[20] Comments on the proposals have been invited from supervisory authorities in countries other than Group of Ten, banks and other interested parties.

C. Reduction of settlement risk

35. As a result of the increased volume of financial transactions both within and across major national and international payment and settlement systems, there has been concern about the ability of the present institutional arrangements to manage the load, in particular the settlement risk (i.e., the risk of the failure of one party to a transaction to complete its obligations in a timely fashion). The concern is not so much the settlement risks run by individual institutions or those of particular market segments, but rather the systematic risk that the failure of one institution to meet its contractual obligations may in turn cause other participants to default, and ultimately disrupt the financial system as a whole.

36. A major innovation in this regard has been the introduction of real time gross settlement (RTGS), in which both sides of a trade are paid simultaneously. By reducing payment-related credit, RTGS systems can significantly lower the probability of payment gridlock in the case of financial disturbance. At the same time, it has been argued that the reduction of payment-related credit may have a negative impact on financial market liquidity.[21]

37. The continued growth in cross-border securities transactions in cash and derivative markets has raised concerns with regard to clearance and settlement practices within the securities industry. Considerable work has been done to clarify the risks associated with securities settlement arrangements. For instance, in February 1997, a report containing a disclosure framework for securities settlement systems was published by IOSCO.[22]

38. In the matter of foreign exchange settlements, the Committee on Payment and Settlement Systems of the central banks of the Group of Ten member countries published a report in March 1996 which revealed not only the difficulty that banks had to control and monitor their foreign exchange settlement risks, but their limited understanding of the extent to which they were running any risk at all. The report helped to foster initiatives by central banks, individual banks and industry groups.[23] In June 1997, for instance, the Group of Twenty, a consortium of the world's leading commercial banks, approved the creation of a global settlements system for foreign exchange transactions. The plan is intended to solve the problem of settlement risk over different time zones by means of a continuous linked settlement, which would allow the two parts of each deal to be synchronized.

D. Improvement of information disclosure and market discipline

39. In addition to strengthened regulations, there are continued efforts to use market discipline as a tool to promote prudent behaviour. The idea is that, with more information available to the public (as well as to regulators), individual and corporate investors will increasingly distinguish weak from strong institutions and will act accordingly. It is expected that, faced with the possibility of an adverse reaction to unwise behaviour, financial institutions will behave more prudently. This discipline will, however, be effective only if financial firms and the public believe that no individual bank or firm will be saved from bankruptcy in the public interest, that is, on the grounds that its demise would threaten the financial system as a whole. This in turn requires participants to believe that the financial system itself is sound.

40. Information disclosure is considered to be particularly important with respect to trading in derivative securities. Large cumulative losses revealed in June 1996 by the Sumitomo Trading Company, arising from trading in the cash and derivatives markets for copper, highlighted imperfections in the global derivatives markets and their regulatory structures. In July 1996, the Governors of the central banks of the Group of Ten member countries approved a framework for the collection of derivatives market data on a regular basis.[24] The data will be compiled by national central banks and published by BIS from end-June 1998.

41. There was also progress at the market level regarding information on derivatives. In the wake of the collapse of Barings Bank in 1995, 49 exchanges, clearing houses, industry groups and regulatory agencies signed an international memorandum of understanding in March 1996; a further 6 organizations joined in June 1996. The Memorandum aims to foster the sharing of market and financial information among exchanges and clearing houses in order to improve the integrity of the global futures and options industry. Despite this progress, a joint follow-up survey on disclosure of derivatives-related activities published by BCBS and IOSCO in November 1996[25] pointed out that important disparities remained with regard to the type and usefulness of the information disclosed by individual institutions.

42. A substantial international effort is still needed to increase the availability of reliable information on the activities of financial and banking firms. The effort can be expected to include the development of international

guidelines on the content and procedures of information disclosure. It has also been argued that increased reliance on market discipline requires further progress in harmonizing accounting and auditing standards, as well as agreement to standardize procedures for dealing with the bankruptcy of internationally active financial firms.[26]

E. Special case of conglomerates

43. One recent feature of financial markets has been the emergence of financial conglomerates — firms that offer a range of financial services and operate in a number of countries. These enterprises complicate the difficulties of supervision in that they give rise to questions regarding the distribution of supervisory responsibility and coordination among the various authorities concerned. This issue was discussed by the Heads of Government at the Lyons and Denver Summit conferences, held in 1996 and 1997. The views of national authorities on the centralization of supervisory responsibilities differ, but there is consensus on the need for further national and international cooperation with regard to the allocation of responsibilities, the exchange of information and the achievement of greater consistency of supervisory methods. It is also recognized that, in appropriate circumstances, there should be a coordinator to facilitate the exchange of information on globally active financial institutions.

44. In May 1996, BCBS and IOSCO agreed to set up additional arrangements for the exchange of information among banking and securities supervisors of diversified financial groups.[27] In a report to Heads of Government at the Denver Summit conference, the finance ministers of the Group of Seven pledged to support changes in laws and regulations to improve the exchange of information and to permit on-site inspection of branches. According to BIS, however, rapid progress in this field is unlikely because of differences in national supervisory arrangements and in the culture of different market segments.[28] The strengthening of cooperative supervisory arrangements, as well as the harmonization of national regulatory standards across borders and the rules applied to different institutions, therefore remain high priorities.

V. Some outstanding issues

45. As indicated in the report of the Secretary-General on sources for the financing of development (see A/52/399), there has been a shift in the composition of financial flows to developing countries from public to private sector sources, with the latter now accounting for an overwhelming share of the total (albeit not for all individual countries). This situation is unlikely to be reversed in the foreseeable future. Developing countries, as well as economies in transition, therefore have an unprecedented interest in the international policies and regulatory measures that condition these financial flows.

46. This interest is heightened further by the fact that the Interim Committee of IMF has decided to promote the liberalization of the capital account among IMF member countries. Some commentators promote complete capital-market liberalization as furthering the benefits of globalization; some embrace the idea as inevitable, given the decreasing capacity of Governments to control capital flows in the present highly-integrated global economy. Others, however, express concern about the vulnerability to financial shocks of more open economies, especially those that are already fragile, and about the far-reaching negative effects on domestic economies and their financial systems.

47. The developed countries have liberalized their capital accounts but have followed diverse paths and different timetables in doing so. Some of them have achieved this objective only comparatively recently: Canada, Germany and Switzerland abolished capital controls in 1973, the United States of America on 1 January 1974, the United Kingdom of Great Britain and Northern Ireland in 1979 and Japan in 1980, but France and Italy did not do so until 1990 and Spain and Portugal only in 1992.[29] For developing countries and economies in transition, one of the primary concerns is therefore deciding how to time liberalization of the capital account with respect to both the stage of a country's overall economic and financial development and other reforms.

48. These concerns have been underlined by the Ministers of the Intergovernmental Group of Twenty-four on International Monetary Affairs. Commenting in advance on the IMF initiative, they underscored the importance of reaching consensus on: a clear and workable definition of the capital account transactions to be covered under the proposed amendment of the IMF Articles of Agreement; the advantages of permanent price-based controls; the consideration of restrictions introduced for political reasons; the need for flexibility to reimpose restrictions under certain circumstances; and confidence that IMF assistance would be available to members facing volatile capital flows.[30]

49. Some of these issues relate to the eleven commandments contained in the revised Declaration on Sustainable Global Growth, adopted by the Interim

Committee of the Board of Governors of IMF. These guidelines and views of IMF on the performance of member countries directly affect the support that IMF provides to individual countries. With the increasing role of private capital flows, however, the views of IMF have gained in importance because of the influence they have on the decisions of the private sector regarding international investments.

50. Moreover, the scope of IMF surveillance has broadened to include areas that were not previously within its remit. In adopting the Declaration, the Interim Committee encouraged the Fund to continue to cooperate with other international organizations in all relevant areas. Some of the issues currently being addressed by IMF, such as governance and the importance of social expenditures, are among those on which some international understanding has been reached in the course of the global conferences and other discussions undertaken within the framework of the United Nations (such as those pertaining to the Agenda for Development). The General Assembly may wish to consider the views of IMF on these issues of mutual concern.

51. The lead role in improving the regulation and oversight of the banking, securities and associated sectors of the international financial system has been taken, largely within BIS, by the Group of Ten and by associations of other regulatory authorities (such as those for stock exchanges and insurance). Membership in BIS has recently been expanded to 41 central banks, including those of developing countries and economies in transition that were invited to become members in September 1996.[31] The Board of Directors of BIS continues, however, to comprise only representatives of the central banks of the Group of Ten. Recognizing the increased importance of developing countries and economies in transition in international capital markets, the various BIS and related forums have sought to involve other countries in the formulation of new or revised regulatory arrangements. Nevertheless, while recognizing these efforts, the Ministers of the Group of Twenty-four in their communiqué of 27 April 1997, emphasized that the developing countries should participate fully in the deliberations and decisions on international supervisory issues.[30]

52. In agreed conclusions 1997/11, arising from discussions at its high-level segment in July 1997, the Economic and Social Council noted that there was a need for an international policy dialogue on issues of policy coherence, and that one of the Council's high-level meetings with the Bretton Woods institutions and WTO should be devoted to that topic.[3] As noted above, there is a degree of commonality in the WTO objective of achieving a level playing field in the financial sector and the efforts being made in various other international forums, mainly within BIS, to develop an adequate regulatory framework. At the same time, it is necessary to ensure that the development concerns of the developing countries and economies in transition are taken into account in both sets of discussions. Such issues of policy coherence could be among those discussed by the Economic and Social Council in its dialogue with the Bretton Woods institutions and WTO, or could be pursued by the General Assembly in its discussion of global financial issues.

Notes

[1] See "Interim Committee Communiqué", *IMF Survey*, 12 May 1997, p. 138.

[2] See *Official Records of the Economic and Social Council, 1997, Supplement No. 15* (E/1997/35).

[3] A/52/3, chap. II. The final report of the Economic and Social Council for 1997 will be issued as *Official Records of the General Assembly, Fifty-second Session, Supplement No. 3* (A/52/3/Rev.1).

[4] See *IMF Survey*, 17 October 1994, pp. 320-321.

[5] See *IMF Survey*, 14 October 1996, p. 327.

[6] See *IMF Survey*, 5 August 1997, pp. 233-238.

[7] Ibid., para. 6 of guidance note.

[8] Ibid., para. 7 of guidance note.

[9] Carl-John Lindgren, et al., *Bank soundness and macroeconomic policy* (Washington, D.C., IMF, 1996).

[10] The cumulative fiscal and quasi-fiscal outlays associated with systemic bank restructuring have come to about 30 per cent of gross domestic product (GDP) in Chile (1981-1987), 20 per cent in Venezuela (1994-present), 10-15 per cent in Spain (1977-1985), Mexico (1994-present) and Hungary (1987-present). The estimated final cost of the 1980s savings and loans crisis in the United States of America was between 2½ and 3 per cent of GDP. See "Financial stability in emerging market economies: a strategy for the formulation, adoption and implementation of sound principles and practices to strengthen financial systems", report of the working party on financial stability in emerging market economies (Basle BCBS, 1997), p. 9.

[11] As well as members of the Basle Committee, those directly involved were representatives from Chile, China, the Czech Republic, Hong Kong (China), Mexico, the Russian Federation and Thailand. Representatives from Brazil, Hungary, India, Indonesia, Malaysia, Poland, the Republic of Korea and Singapore were closely associated with the work.

[12] See "Core principles for effective banking supervision", BCBS consultative paper, Basle, April 1997. The paper is available on the BIS Web site, www.bis.org, as BCBS No. 30.

[13] The working party consisted of representatives of Argentina, France, Germany, Hong Kong (China), Indonesia, Japan, Mexico, the Netherlands, Poland, the Republic of Korea, Singapore, Sweden, Thailand, the United Kingdom of Great Britain and Northern Ireland and the United States of America, under the chairmanship of Mario Draghi, Chairman of the Deputies of the Group of Ten. The working party also included representatives from BCBS, the European Commission, IMF, the International Organization of Securities Commissions (IOSCO), the Organisation for Economic Cooperation and Development and the World Bank. In addition, it consulted with other international groupings and received contributions from a number of regional development banks and market participants.

[14] See "Financial stability in emerging market economies ...".

[15] See *IMF Survey*, 5 August 1997, pp. 233-238, para. 8 of guidance note.

[16] The Fund and the World Bank were preparing a joint paper for their executive boards on their respective roles and on coordination between them and with other international organizations.

[17] The Internet address of DSBB is http://dsbb.imf.org.

[18] The Philippine peso had come under pressure following the devaluation of the Thai baht on 2 July. On 10 July, the peso was allowed to float within a wider band against the United States dollar (permitting its fall), and new policy commitments were undertaken, including limiting the exposure of banks to the real estate market, discouraging the growth of foreign currency liabilities through new liquidity requirements, and removing tax disincentives to holding peso deposits.

[19] The use of internal models has not gained universal support. Opponents have argued that regulators would not be able to verify the quality of internal models or their projections. According to one study, VAR results may vary, depending on the model and parameters chosen, by more than 14 times for the same portfolio (Tanya S. Beder, "VAR: seductive but dangerous", *Financial Analysts Journal*, September-October 1995, p. 12). On the other hand, most of the recent huge trading losses had been accumulating over a very long period, suggesting shortcomings in internal risk management processes in some long-established and substantial firms. The primary goal of allowing the use of internal models is to enhance these internal systems and it is argued that the adoption of a single, rigid approach might block the development of improved techniques.

[20] "Principles for the management of interest rate risk", Basle, January 1997. The paper is available on the BIS Web site, www.bis.org, as BCBS No. 29.

[21] See, for instance, David Folkers-Landau, Peter Garber and Dirk Schoenmaker, "The reform of wholesale payment systems", *Finance and Development*, June 1997, pp. 25-28.

[22] IOSCO and CPSS, "Disclosure framework for securities settlement systems", February 1997; the report (CPSS No. 20) is available on the BIS Web site, www.bis.org. The framework, structured in the form of a questionnaire, is designed to help market participants and regulators organize and understand the information that they need in order to appraise the risks potentially associated with securities settlement systems.

[23] BIS, *67th Annual Report* (Basle, 9 June 1997), p. 177.

[24] See "Proposals for improving global derivatives market statistics", Basle, July 1996. The framework is available on the BIS Web site, www.bis.org, as ECSC No. 6.

[25] See "Survey of disclosures about trading and derivatives activities of banks and securities firms", Basle and Montreal, Canada, November 1996. The survey is available on the BIS Web site, www.bis.org, as BCBS No. 28.

[26] William R. White, "International agreements in the area of banking and finance: accomplishments and outstanding issues", Working paper No. 38, BIS Monetary and Economic Department (Basle, October 1996), p. 31.

[27] See "Response of the Basle Committee on Banking Supervision and of the International Organization of Securities Commissions to the request of the Group of Seven Heads of Government at the June 1995 Halifax Summit" (Montreal, Canada, IOSCO, May 1996).

[28] BIS, *67th Annual Report* ..., p. 169.

[29] John Eatwell, "International financial liberalization: the impact on world development", United Nations Development Programme, Discussion Paper Series, No. 12, 1997.

[30] See "Group of 24 Communique", *IMF Survey*, 12 May 1997, p. 143.

[31] These were the Banco Central do Brazil, The People's Bank of China, the Hong Kong Monetary Authority, the Reserve Bank of India, The Bank of Korea, the Banco de Mexico, the Central Bank of the Russian Federation, the Saudi Arabian Monetary Agency and The Monetary Authority of Singapore (BIS, *67th Annual Report* ..., pp. 183 and 190).